



Issue Date	May 6, 2005
Audit Report Number	2005-DE-1004

TO: Frank L. Davis, General Deputy Assistant Secretary for Housing, H

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 8 AGA

SUBJECT: Aspen Home Loans, American Fork, UT, Did Not Follow Federal Housing Administration Requirements for Loan Origination and Quality Control

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited Aspen Home Loans, LC's (Aspen) main office in American Fork, UT, and two branch offices in Orem and Draper, UT. We determined an audit was warranted based on loan origination and quality control deficiencies identified during a prior audit. In addition, the U.S. Department of Housing and Urban Development (HUD) Quality Assurance Division performed a Title II monitoring review at Aspen in March 2002, identifying similar deficiencies.

Our audit objectives were to determine whether Aspen complied with HUD regulations, procedures, and instructions in the origination of the Federal Housing Administration-insured loans selected for review and to determine whether Aspen's quality control plan, as implemented, met HUD requirements.

### **What We Found**

Aspen did not comply with HUD regulations, procedures, and instructions in the origination of the 11 loans selected for review. Loans were originated by independent contractors who were self-employed individuals. In addition, Aspen operates out of unapproved branch offices. We also identified one loan that did not have a proper verification of employment.

Aspen's quality control plan is incomplete and inadequate as implemented. For example, (1) the required number of quality control reviews is not performed; (2) the owner, who also originates insured loans, is the only quality control reviewer; (3) quality control reviews are not performed or reported accurately; (4) the owner did not know about the HUD requirement that all early default loans be reviewed in addition to the normal random sample selection; and (5) the owner is the branch manager for three separate office locations.

### **What We Recommend**

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require Aspen to change its policies and procedures for the origination and review of its insured loans to fully comply with all HUD regulations, obtain the necessary branch approval, cease origination of insured loans at unapproved branches, and indemnify one insured loan not originated in accordance with HUD requirements. In addition, we recommend that Aspen be referred to the Mortgagee Review Board for appropriate action since HUD and the Office of Inspector General (OIG) identified similar deficiencies in the area of quality control.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06 REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided finding outlines to Aspen on February 2, 2005, provided a complete draft report on March 24, 2005, requested comments by April 7, 2005, and received Aspen's comments on April 15, 2005. Aspen agreed with the findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

# TABLE OF CONTENTS

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Background and Objectives	4
Results of Audit	
Finding 1: Aspen Did Not Comply with HUD Requirements in the Origination of Insured Loans	5
Finding 2: Aspen's Quality Control Plan is Deficient	8
Scope and Methodology	11
Internal Controls	12
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	13
B. Auditee Comments and OIG's Evaluation	14

## **BACKGROUND AND OBJECTIVES**

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Aspen originally incorporated as Aspen Financial, LC, under the laws of the State of UT and began operations in 1998. Aspen is a limited liability company and was approved by HUD to originate insured loans as a nonsupervised loan correspondent on August 30, 2000. At the time of its HUD approval, it used Aspen Home Loans, LC, as its “doing business as” name. Effective October 6, 2003, Aspen Financial, LC, officially became Aspen Home Loans, LC.

HUD’s Neighborhood Watch system shows Aspen’s main office located at 826 East State Road, American Fork, UT, with one branch office located at 2801 Camino Del Rio South, San Diego, CA. HUD’s system also shows four terminated branch offices, all located at 1798 West 5150 South, Roy, UT. During our audit, we confirmed that Aspen’s main office is located at 826 East State Road, American Fork, UT; however, it also operates out of two branches in Orem and Draper, UT (see finding 1).

Aspen originated 870 government-insured loans with a beginning amortization date between April 1, 2001 and August 31, 2004, for properties located in UT with a total original mortgage amount of \$109,706,143. On August 31, 2004, HUD’s Single Family Data Warehouse showed that of the 870 insured loans, 571 (65 percent) are active, 14 (2 percent) insurance claims were paid, and 285 (33 percent) loans were terminated. As of February 22, 2005, 28 insurance claims have been paid, representing a significant increase in less than six months. In addition, during our audit period, 54 loans were in default at one time, and as of February 28, 2005, 16 loans are still in default.

The objectives of our review were to determine whether Aspen complied with HUD’s regulations, procedures, and instructions in the origination of insured loans selected for review and to determine whether Aspen’s quality control plan, as implemented, met HUD’s requirements.

## RESULTS OF AUDIT

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### Finding 1: Aspen Did Not Comply with HUD Requirements in the Origination of Insured Loans

Aspen's loan origination operations did not comply with HUD requirements. Aspen allowed independent contractors, self-employed individuals as defined by Internal Revenue Service Form 1099, to originate Federal Housing Administration-insured loans. In addition, Aspen operates out of two unapproved branch offices. Aspen does not have written policies and procedures for the origination of government-insured loans, and management does not provide direct supervision over its contract loan officers. We identified one loan in which the verification of employment was improper. These deficiencies stemmed from Aspen's disregard for HUD's requirements and increase the risk to the insurance fund.

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#### **Independent Contractors Originated Government- Insured Loans**

Aspen, using verbal agreements, contracted with self-employed loan officers to originate Federal Housing Administration-insured loans. Aspen provides little or no oversight of the operations of these contractor loan officers. Several of these independent contractors were incorporated as limited liability corporations whose business purpose was stated as originating home loans. For those loan officers who were incorporated, Aspen would pay their commissions directly to the corporation.

Aspen charges its contract loan officers a nominal fee of approximately \$450 per loan for the use of its Federal Housing Administration approved status. It also requires them to pay their own loan processing and operating costs, such as advertising, and all home office expenses. Aspen does not have written policies and procedures for the origination of government-insured loans; it relies solely on the experience of its contract loan officers to comply with HUD directives.

HUD does not allow the contracting out of certain loan origination functions; this includes those of a loan officer. The lender is held responsible for the quality of loans and compliance with HUD requirements.<sup>1</sup> Additionally, a lender must pay all of its operating expenses.<sup>2</sup>

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<sup>1</sup> Mortgagee Letter 95-36

<sup>2</sup> Mortgagee Approval Handbook 4060.1, REV-1

## **Unapproved Branch Offices**

HUD did not approve the two branch offices located in Orem and Draper, UT, and had not received the branch applications, as alleged by Aspen, as of February 11, 2005. Aspen obtains Federal Housing Administration case numbers from its unapproved location in Draper, UT, which is not allowed by HUD.

HUD-insured mortgages may only be originated, serviced, purchased, held, or sold by lenders that have been approved by HUD. Lenders are not allowed to take on an existing, separate entity to originate insured mortgages under the lender's HUD-approved number.<sup>3</sup>

One of the loans in our sample, case number 521-5808778, did not have its record of employment properly verified by the contract loan officer. Had the employment verification been accomplished properly, the contract loan officer would have discovered that one of the borrowers had lost his job before loan closing, and the loan would not have passed the underwriter's credit analysis.

HUD requires lenders to establish the anticipated amount of income and the likelihood of its continuance to determine the borrower's ability to repay the mortgage debt. This entails a verification of a borrower's income for the most recent 2 full years and assurance that the borrower's income can be reasonably expected to continue for at least 3 years.<sup>4</sup>

## **Aspen Ignored HUD Regulations**

Aspen ignored HUD regulations and used contract loan officers and unapproved branch offices to originate Federal Housing Administration-insured loans. Because its loan officers were self-employed individuals who were purportedly experienced at originating government loans, management did not provide direct supervision and oversight of their loan origination processes. Aspen also did not monitor the performance of its loan officers using its quality control program because it relied mostly on its sponsors to conduct quality control reviews (see finding 2). Aspen passed on all responsibility for the oversight of loan officer functions to the contract loan officers themselves and to its sponsors, thus relieving itself from employing additional personnel to perform as branch managers and/or quality control reviewers (see finding 2).

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<sup>3</sup> Mortgagee Letter 00-15

<sup>4</sup> HUD Handbook 4155.1

## **Improvements Made by Aspen**

It should be noted that Aspen was implementing changes to its operations during our on-site visit and should continue to do so based on our recommendations, as well as the State of Utah's regulatory changes. For example, Aspen is changing all of its independent contractors (1099 paid employees) to employees. After interviewing several contract loan officers, HUD's Office of Inspector General (OIG) confirmed that Aspen employees are aware of the upcoming change. In addition, Aspen is attempting to get all of its branch offices approved as required by HUD.

## **Conclusion**

Aspen's operations are in direct violation of HUD directives and leave HUD's insurance fund exposed to an increased risk.

## **Recommendations**

We recommend that the Assistant Secretary of Housing – Federal Housing Commissioner

- 1A. Require Aspen to change its policies and procedures for the origination of Federal Housing Administration-insured loans to fully comply with all HUD directives and regulations.
- 1B. Require Aspen to obtain branch approval status from HUD for its Draper and Orem, UT, offices, cease requesting Federal Housing Administration case numbers from the Draper, UT, office until the proper approval status is obtained, and refrain from originating insured loans from any unapproved branch offices.
- 1C. Pursue indemnification for the one insured loan, 521-5808778, with an unpaid principal balance of \$130,230, not originated in accordance with HUD requirements.

## RESULTS OF AUDIT

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### Finding 2: Aspen's Quality Control Plan is Deficient

Our audit disclosed that Aspen's quality control plan does not contain all of the elements required by HUD, the plan was not correctly implemented, and Aspen was unable to provide the OIG with quality control reviews or related reports that followed HUD-prescribed quality control procedures. The deficiencies associated with Aspen's quality control process stemmed from its disregard for HUD's and its own requirements. Further, Aspen relied mainly on its sponsors to ensure the propriety of information used to support the approval of a borrower for an insured loan. The failure to implement a quality control plan and perform sufficient reviews prevents Aspen from ensuring the accuracy, validity, and completeness of its loan origination operations. As a result, potential deficiencies may not be identified and corrected in a timely manner, resulting in an unnecessarily high risk to the Federal Housing Administration insurance fund.

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#### **Aspen's Quality Control Plan Is Deficient**

Our review disclosed that Aspen's quality control plan did not contain all of the elements required by HUD. For example, the plan did not include procedures to expand the scope of a quality control review when fraud or patterns of deficiencies exist. In addition, the plan did not accurately reflect the random sample selection process for selecting loans for review. Further, the plan did not ensure records for quality control review findings and related corrective actions taken were maintained.

Aspen's quality control plan was not correctly implemented. For example, the owner of Aspen performed all quality control reviews while he also served as a loan officer. This is strictly prohibited by HUD regulations. Further, the owner of Aspen was unaware of HUD's policy that all loans which default within the first six months of origination have a mandatory quality control review performed. Additionally, Aspen's owner served as the Branch manager for all three offices, which is in direct violation of HUD regulations (see finding 1).<sup>5</sup>

Aspen's quality control reviews lacked documentation, and Aspen was unable to provide OIG with adequate quality control review reports. For example, for the eight quality control reviews performed by Aspen and reviewed by OIG, there was no documentation of the procedures performed. The reports consisted of a simple paragraph stating who the loan officer and processor were and such vague statements as "seems to be a good file". If any discrepancies were identified, there was never any documentation of action(s) taken.

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<sup>5</sup> HUD Handbook 4060.1, REV-1



As a condition of HUD approval, Aspen is required to have and maintain a quality control plan for the origination of insured loans. The quality control plan must be a prescribed function of Aspen's operations and provide for an independent evaluation of its loan origination operations. Mortgagees may choose to review the lesser of ten percent of all loans closed on a monthly basis, or a random sample that provides a ninety-five percent confidence level with two percent precision. If the lender closes fewer than ten loans annually, the reviews may be conducted quarterly. The lender is responsible for determining the number of loans to be reviewed based on HUD's sample size and loan selection requirements. In addition to the loans selected for routine quality control review, the lender is required to review all loans that default within the first six months.<sup>6</sup>

### **Disregard of Requirements**

The deficiencies associated with Aspen's quality control process stemmed from its disregard for HUD's and its own requirements. In addition, Aspen's owner, operating out of Aspen's American Fork main office failed to provide adequate guidance and assurance that all of its offices including the Orem and Draper branch offices were operating in accordance with HUD requirements. There was little or no ongoing management supervision over the main office or the branch offices. Further, Aspen transferred most of its responsibility for quality control to its loan officers and sponsors. Aspen relied mainly on its sponsors to ensure the propriety of information used to support the approval of a borrower for an insured loan. Aspen did not perform regular and ongoing reviews of loan officer performance and work performed as required by HUD.

Further, HUD's Quality Assurance Division, during its Title II monitoring review of Aspen in March 2002, identified similar deficiencies to those that OIG identified during our current audit. HUD found that Aspen had not fully implemented its quality control plan; for example, required reviews were not performed. Aspen took no corrective action on these deficiencies, which constitutes a repeat finding in the area of quality control.

### **Improvements Made by Aspen**

It should be noted that Aspen was implementing changes to its operations during our on-site visit and should continue to do so based on our formal recommendations. For example, Aspen talked with other loan correspondents about their quality control review process and plans to look into independent quality control reviewers. In addition, the owner is fully aware that he needs to input a branch manager at each branch office, as well as the home office, to provide direct supervision for the loan officer and loan correspondent employees.

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<sup>6</sup> HUD Handbook 4060.1, REV-1

## **Conclusion**

The failure to implement an effective quality control plan and perform sufficient reviews prevents Aspen from ensuring the accuracy, validity, and completeness of its loan origination operations. As a result, potential deficiencies may not be identified and corrected in a timely manner, resulting in an unnecessarily high risk to the Federal Housing Administration insurance fund.

## **Recommendations**

We recommend that the Assistant Secretary of Housing-Federal Housing Commissioner:

- 2A. Take the appropriate administrative action, to include referral to the Mortgagee Review Board.

## SCOPE AND METHODOLOGY

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Our audit generally covered the period of April 1, 2001 through August 31, 2004. When applicable, we expanded the audit period to include current data. We conducted our fieldwork from January through February 2005. Our audit entailed the review of 11 insured loans from the universe of 870 such loans originated by Aspen during our audit period for properties located in Utah. The results of our testing apply only to the 11 loans reviewed and cannot be projected to the universe of 870 loans. Our audit approach was to identify and evaluate the internal controls in place over the key areas of operation of Aspen's Federal Housing Administration-insured loan origination activities.

Of the 870 insured loans, five loans were selected as part of survey audit work performed under AutoAudit assignment DE 03 0007 - Use of Contract Loan Officers by Utah Mortgagees. We selected an additional six loans as part of the audit phase performed under Auto Audit assignment DE 05 0001 - Aspen Home Loans. Therefore, we selected 11 insured loans originated by Aspen with a beginning amortization date between April 1, 2001 and August 31, 2004, with one or more of the following characteristics:

- (1) Property located in Utah;
- (2) Indication the borrower or coborrower(s) social security number may be in error;
- (3) Identified as being in default at one point or had an insurance claim paid;
- (4) Default status and default reason code was a 46 or 6 respectively which means a "property was conveyed to insurer" and "curtailment of borrower income"; and
- (5) A low number of payments made before default (e.g., less than 6 months).

In addition, we relied, in part, on data maintained by HUD in the Single Family Data Warehouse. We did not perform a detailed analysis of the reliability of HUD's Single Family Data Warehouse data.

To accomplish the audit objectives, we examined Aspen's loan origination, quality control, and finance records. We also reviewed applicable HUD records relating to Aspen's loan correspondent activities. We conducted interviews with Aspen officials, independent contractors or nonemployees at Aspen, officials from HUD's Office of Program Compliance and Lender Activities, officials from Denver's Quality Assurance Division, and an official from HUD's Mortgagee Review Board. During the survey phase, we also conducted interviews with borrowers (if applicable) and obtained information from their current and past employers.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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Internal Control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Loan Origination Process – Policies and procedures established by management to ensure Federal Housing Administration-insured loans are originated in accordance with HUD requirements and
- Quality Control Process - Policies and procedures established by management to ensure the quality control plan has been implemented and related reviews are performed in accordance with HUD requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our review, we believe significant weaknesses exist in two areas:

- The loan origination process (finding 1) and
- The quality control process (finding 2).

The deficiencies are discussed in detail in the Results of Audit sections of the audit report.

## APPENDIXES

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### Appendix A

#### **SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE**

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Recommendation Number	Funds To Be Put to Better Use 4/
1C	\$130,230

- 4/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

#### Comment 1

US Department of Housing and Urban Development  
Mr. Ronald J. Hosking/Regional Inspector General for Audit  
Office of Audit, Denver, Colorado

Re: Aspen Home Loans, LLC  
826 East State Road  
American Fork, Utah

Dear Sir/Madam,

This is a formal written response to the findings that were brought forth from the HUD audit dated March 24, 2005.

#### In Response to Finding #1:

AHL has reviewed the auditor's recommendations and is in the process of implementing all recommendations made by the audit committee. It is the desire of the ownership of AHL to fully comply with the policy and procedures that HUD requires for approval as a HUD lender. It is anticipated that AHL will be able to implement the majority of HUD recommendations by June 1, 2005.

In regards to allowing loan originators to act as independent contractors, AHL has already begun the process of phasing out this model and will require that all loan originators become full time employees. This should resolve any issues pertaining to this concern, and will ensure that AHL is in compliance to HUD guidelines.

As part of this re-structuring AHL ownership has been told by its loan originators that there still exists a handful of HUD approved lenders locally that are representing that their company will allow them to work as independent contractors. If this is correct, AHL feels the continuation of this model by other entities places our company at a severe competitive disadvantage. Therefore we respectfully ask for assistance from HUD to insure that all lenders are in compliance. We are finalizing the proper structure for compensation on all loans with our attorney and CPA to insure we will be in HUD compliance. We expect this to be no later than June 1, 2005.

In regards to identifying deficiencies in our quality control procedures, AHL is willing to accept HUD recommendations that it institute a more aggressive written policy and procedures manual, as well as re-designing and updating our current quality control procedures in written form to comply with HUD guidelines. It is anticipated that this endeavor will be completed by June 1, 2005. Special emphasis will be taken to implement the HUD recommendations of increasing the number of quality control reviews by a qualified independent entity. AHL will no longer allow ownership to fulfill this role for the company as recommended in the auditor's findings.

In regards to AHL originating loans out of two unapproved branch offices, AHL is in the process of remedying this situation by taking the necessary steps to make certain that

these two offices are in compliance to HUD guidelines for operations. While AHL does maintain that it did send out branch applications for approval for these two entities, it recognizes that formal HUD approval of these branches is required; therefore AHL will diligently work towards complying with HUD guidelines.

With regards to the inaccurate verification of employment, AHL management is aware of the underwriting guidelines as set forth by HUD to establish the anticipated amount of income and the likelihood of continuance to determine the mortgage debt. In response, AHL will begin implementing a series of loan origination training workshops to make certain that our loan officers receive additional training on HUD underwriting guidelines, policies and procedures. Proper training of our employees, combined with the revision of our policies and procedures should assist AHL in remedying this situation. AHL would also like to point out the complex issue of post-closing findings, and the inherent struggle to ensure the integrity of individual loan originators. In short, AHL is addressing this deficiency in an aggressive manner as recommended by HUD.

In response to HUD recommendations, AHL has recently hired additional personnel in management, as well as exploring the feasibility of relocating all processing into a centralized location. These decisions were primarily based on an overall assessment by ownership of AHL business model. Future changes will be implemented in the near future and AHL is grateful to HUD for their acknowledgement that some of HUD recommendations are already in the process of being implemented companywide.

With regards to the auditors conclusions that AHL is in direct violation of HUD directives and leaves HUD insurance fund exposed to higher risk, we respectfully ask that HUD recognize that AHL is taking appropriate measures to limit HUD exposure. The implementation of HUD recommendations in this audit report is a direct reflection of our desire to accomplish this goal. Please note that all loans currently originated by AHL are underwritten by the individual investors. AHL is not currently a DE. Therefore we believe that our investors also share some burden on this as well. As FHA loans are such a small portion of our overall business, we feel that the underwriting performed by the investors is superior to what we could offer.

There are only two authorized processors that AHL allows to process FHA loans and all efforts are made to insure that no loan officer is submitting FHA loans directly to an investor that is not properly processed. We do acknowledge that this has happened on occasion in the past, but it is against our policy.

In response to Case Number 521-5808778, AHL is in the process of reviewing this file to seek the necessary remedy to resolve this situation. It appears that AHL may have some liability on this case due to negligence on the part of the originator, which was not discovered at the time of underwriting. AHL will continue its in-house investigation of this occurrence and report its findings to HUD at a later date.

In Response to Finding #2:

AHL has already stipulated that it recognizes HUD concerns in regards to its existing quality control plan and is taking measures to resolve this deficiency. AHL recognizes that as a requirement for HUD approval, it must have and maintain a quality control plan for the origination of insured loans. Appropriate action is being taken by the ownership of AHL to ensure that our policy and procedures are in compliance with HUD recommendations.

AHL would like to state for the record that it was not the intent of ownership to give the impression that it had no regard for HUD requirements. However, AHL recognizes that based on HUD findings and recommendations it is understandable that the auditor might reach this conclusion. AHL respectfully acknowledges its past deficiencies and will work in earnest to implement all of the HUD recommendations as outlined in this audit report in a timely manner. The ownership of AHL wishes to convey to HUD their commitment to comply with HUD requirements.

In regards to the HUD recommendation that AHL hire a full-time Branch Manager at every branch, ownership is exploring this option as well as the possibility of closing one or more of our branch locations in order to comply with HUD recommendations. AHL recognizes HUD concerns with regards to the proper supervision for the loan officer and loan correspondent employees and is seeking to remedy this situation to ease HUD concerns on this issue.

With regards to the scope and methodology of the audit, AHL recognizes that the two findings indicated by the auditors are valid and require ownership to respond accordingly. AHL ownership feels confident that we have addressed and responded to the auditors concerns in a professional manner and that all findings as outlined in the auditors report are being remedied by AHL ownership. It is the hope that AHL will be given the opportunity to improve itself by implementing the directives included in HUD recommendations outlined in the auditors report.

Respectfully submitted,



L. Kelly Hatch  
President, Aspen Home Loans, LLC  
801-642-0070



### **OIG Evaluation of Auditee Comments**

**Comments**    Aspen Home Loans, LC agrees with OIG's audit findings and recommendations.